# Valuation Methods

## Valuation Methodology

- There are numerous ways to value a company quantitatively and no one method is superior to all others
- Valuation is part science and part "gut"
- 3 categories:
  - Asset-based: rarely used now as mfg. shifts out of the U.S.
  - Cash flow capitalization, and
  - Multiples, widely used for entrepreneurial co's.

## Multiples

- Cash flow multiples
  - EBITDA X (3 to 10)
  - Adjusted up and down for contextual factors.
  - May adjust EBITDA for founder salaries.
- Free cash flow multiples.
  - EBITDA – CAPEX
  - Yields more conservative valuation
  - Used when company requires major CAPEX to sustain growth

## Multiples

- Sales multiples
  - Widely used, varies by industry
  - Food industry = 1 to 2 X revenues
  - Professional services = 1 to 3 X revenues
  - Software companies = 2 to 3 X revenues
- P/E ratio method
  - For publicly traded companies
  - Private companies can be based on "comps"

## Free Cash Flow

- Most complicated and involved
  - AKA Discounted Cash Flow model
- Relies on many projections and assumptions
- Simply stated, projected future cash flows (generally 5 years), adjusted for taxes, depreciation, working capital and CAPEX, are discounted to PV using the weighted average cost of capital of the company PLUS residual value

## Free Cash Flow Formula

- Year 1 FCF/(1+DR)+Year 2 FCF/(1+DR)^2 +Year 3 FCF/(1+DR)^3 . . . + RV
- Many criticize model due to its complexity and uncertainties
- Bill Sutter (venture capitalist and Stanford Business School grad) says "I have not used any models since business school – valuation is remarkably unscientific"

## Valuing Technology/Internet Companies

- Valuation methods discussed thus far are not applicable for valuing tech companies
- Early companies like Netscape, Yahoo, and Amazon.com all went public with little to no revenues at very high valuations
- Current models now focus on users and ultimate revenues attached thereto
- Ultimately, financial fundamentals count

## Summary

- Many valuation methods, none of which is particularly better than others
- Valuation, particularly for early stage companies, is highly subjective
- Valuation is "educated speculation"
- Internet/tech companies don't fit traditional models